



AMERICAN
BANKRUPTCY
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Central States Bankruptcy Workshop

Best Practices: Transactional Drafting

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Best Practices When Negotiating and Drafting Asset Purchase Agreements and Bid/Sale Motions

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The Hypothetical for the Day

The Facts

- Vitalogy Furniture, Inc., a furniture retailer in Chicagoland, needs to sell quickly under § 363 because of tight timelines in the cash collateral order. Assets: FFE, inventory, IP
- Debts: \$50 million to the Bank, \$3 million in 503(b)(9)s, \$47 million in general unsecured claims.
- On filing, Debtor announces going out of business sale at 5 of 15 stores. Est recovery is \$20 million.
- Insider organizes the stalking horse group to bid on the Ten Stores remaining:
 - The “Vedder Group” made up of the family owners and key suppliers
 - \$30 million purchase price, which is the est. value of the inventory at the Ten Stores.
 - Assumption of customer deposits, employee obligations, real property leases, preservation of 800 jobs.
 - Contemplates continuing operations as a going concern.
 - Avoidance actions are included as “assets” in the APA.
 - Would pay some cure costs for leases and contracts.
- Insider is the only qualified bid after extensive marketing.
- Liquidator, Rearviewmirror, at the eve of sale approval offers:
 - \$4 million more than the stalking horse.
 - Excludes avoidance actions.
 - Paid at conclusion of liquidation.

Objective: Strategic, Consistent, and Clear Drafting at Each Stage



APA Negotiation



Bid Procedures & Auction



Sale Order

The Asset Purchase Agreement

The Asset Purchase Agreements

- Key negotiated provisions:
 - Stock or Asset Purchase
 - Acquired Assets (discussion points, whole sale or parts, how that plays into negotiation when finding a stalking horse bidder, importance of specificity)
 - Assumed Liabilities (how this plays into valuation of bids, importance of specificity)
 - Assumed Executory Contracts/Leases (identify contracts to be assumed or assigned or contracts *not* to be assumed and assigned, why you may choose one method over the other depending on the deal structure)
 - Carefully drafted and noticed/served cure notices are essential
 - Employee/Labor Issues
 - Intellectual Property
 - Post acquisition purchase price true-ups
 - Transition services



The Asset Purchase Agreement (cont.)

- Stalking Horse Bidder (may be a strategic or a credit bid)
 - Needs incentive to be the first bidder
 - Due diligence burden
 - Sets floor for the terms of the transaction
 - Competition from other bidders
- Negotiated Incentives
 - Expense reimbursement
 - Break-up fee
 - Bid protections

The Asset Purchase Agreement (cont.)

- Credit Bidding
 - Section 365(k) of the Bankruptcy Code permits a creditor with a lien on assets to credit bid its “allowed claim” “unless the court for cause orders otherwise.”
 - Generally, must allow credit bidding if the proposed sale is to be free and clear of secured lender’s liens.
 - RadLAX—Supreme Court held that a debtor cannot confirm a cram down plan that provides for the sale or collateral without permitting the secured lender to credit bid
 - However, if there is a dispute about the secured lender’s claim—the amount, the priority of the lien, etc.—the Court may impose limitations on the secured lender’s credit bid.
 - Diligence on the secured lender’s claim is essential in credit bid scenarios.

The Asset Purchase Agreement (cont.)

- Tax Considerations When Drafting APAs
 - Exemption from transfer and bulk sales taxes in certain circumstances
 - Illinois Dept. of Revenue v. Hanmi Bank, 895 F.3d 465 (7th Cir. 2018)
 - Debtor generally recognizes cancellation of debt income
 - Ability to preserve NOLs—IRC Section 368(a)(1)(G)— “G Reorganization”
 - Valuation considerations—if the fair market value of the assets exceeds the tax basis, the purchaser may be entitled to a step-up

The Bid Procedures and Auction

Bid Procedures Issues

- Break-Up Fees & Other Bid Protections
 - Given to Stalking Horse to induce the initial bid
 - Sets a floor price
 - Compensates Stalking Horse for due diligence, loss of business opportunity, negotiating the APA
 - Vary in amount. Typical seems to be 2-4% of Purchase Price (including, or not, expense reimbursement)
 - Approved in the Sale Procedures Order
 - Break-Up Fees and/or Expense Reimbursement: Judged under § 363(b) (business judgment) or § 503(b) (actual & necessary benefit to the estate)
 - In the Matter of Bouchard Transportation Company, Inc., 74 F.4th 743 (5th Cir. 2023)(refusing to decide which standard to apply)
 - In re NextEra Energy, Inc., 904 F.3d 298 (3rd Cir. 2018)(applying administrative expense standard)(cert. denied)
 - In re Genco Shipping & Trading Ltd., 509 BR 455 (Bankr. SDNY 2014)(applying business judgment standard.
 - Initial Overbid/Topping Bid
 - Additional bid increments
 - Exclusivity?
 - Careful with insider offers

Bid Procedures Issues (cont.)

- Form of the APA
- Qualified Bidder Status
 - Financial ability to close
 - Requiring cash purchase price
 - Earnest money
 - Prohibiting financing and diligence contingencies
- Whole or Sum of the Parts
- Credit Bidding
 - § 363(k): Creditors secured in the assets to be sold may credit bid their allowed claim “unless the court orders otherwise”
 - What is cause to order otherwise? More than chilling of bids, more than a claim objection, more than inequitable conduct. Maybe: Secured claim is subject to a genuine dispute based on an objective evidentiary record. *In re Figueroa Mountain Brewing, LLC*, 2021 WL 2787880 (Bankr. C.D. Cal. 2021).
- Determining Highest and Best Bidder
 - Mixed lots
 - Earnouts
 - Conflicting contingencies – employees, landlords, secured creditors
- Back Up Bidders

Auction

- Procedures should be part of Sale Procedures Order
 - Location – in person/virtual/court room
 - https://www.cacb.uscourts.gov/sites/cacb/files/documents/judges/instructions/ER_GuidelinesforSection363Sales.pdf
 - Time between bids
 - Skipping rounds
 - Who can attend
 - Flexibility to account for surprises
- Joint ventures
 - *In re New Energy Corp.*, 739 F.3d 1077 (7th Cir. 2014)
 - *In re The Bon-Ton Stores, Inc.*, Case No. 18-10248 (Bankr. Del.)

The Sale Motion and Order

Sale Order

- 363(m), good faith findings
- Which controls, Sale Order or APA
- Waiver of Rule 6004(g) 10 day stay
- Free and clear of liens/interests. What can and cannot be released
 - Products liability claims
 - Environmental issues
- Understand limitations on what judges can order (i.e. waiver of transfer taxes under 1146(c)—which only applies to sales within a plan of reorganization; control of third-party regulators such as liquor control commissions and other licensing bodies; transfer of licenses)

Transition Services/Management Agreements

- Definition: seller agrees to provide certain services to a buyer during the transition period following the acquisition to prevent business disruption. Reverse TSA: buyer provides services to seller during transition
- Agreement as to scope, timing, standard of service, costs
- Scope: what transition services will the seller (or buyer) continue to provide?
- Timing: how long will the transition services continue?
- Standard of Service: What are the buyer's expectations for seller? Be specific. Avoid use of words like reasonable, commercially reasonable, or best efforts
- Costs: what will buyer pay for the seller's assistance? Credits, liquidated damages, direct damages, escrowed funds
- Third party consents: understand when needed. Should be identified in due diligence phase.
- Data used: will personally identifiable information or other confidential/proprietary information be disclosed? If so, need appropriate safe guards
- Common uses
 - IT
 - Accounting
 - Human Resources
 - Liquor licenses. Management agreements in the liquor industry allow a licensee to retain ownership of the license in its own name while delegating rights and responsibilities to a manager

Practice Pointers and Final Thoughts

Practice Pointer #1: Do Not Use Legalese

- Business leaders should not have to call an attorney to interpret a contract they need to administer
- Language must be accessible
- It's not just my opinion: In 2010 the Congress passed and President Obama signed the Plain Writing Act, whose stated purpose was "promoting clear government communication that the public can understand and use."
- Defining parties. Use real names. Consider not using words like "assignor/assignee". Less confusion and less likely to use the wrong name
- Popular/Unpopular opinion: Do not use the word SHALL. Use must, may, or will. Bryan Garner has an entire 60 minute seminar on why we should never use the word shall.



Practice Pointer #2: Be Wary of Precedent

- Most APAs and Sale Orders contain boilerplate and provisions that are bespoke to the particular transaction
- If using precedent as a template, read thoroughly and do not assume "boilerplate" provisions are standard or applicable to you deal
- Copying over definitions may have unintended consequences
- For key definitions, i.e. "Assumed Liabilities", "Sellers", "Acquired Assets", etc, track carefully through the documents to ensure intended uses.



Practice Pointer #3: Consult Local Rules and Local Practices

- Be sure to check local rules, the Judge's procedures, and precedent
- What flies in Delaware/SDNY may not work in every court
- If using local counsel, engage them early in the drafting (and listen when they tell you to make a change)
- Review approved bid procedures and sale orders from your Court and Judge—pull more than one

**Final Thoughts
from the Bench**

Faculty

Rebecca R. DeMarb is a partner with Swanson Sweet LLP in Madison, Wis., where she represents companies in financial trouble and serves as a fiduciary for those same types of companies. She has more than 25 years of industry experience in hospitality, international receiverships, manufacturing, service businesses, construction, food and beverage manufacturing, intellectual property, c-stores, retail, e-businesses, dealerships, medical technology, all types of real estate, health care, agriculture and more. Courts have appointed Ms. DeMarb as receiver for more than 15 years in Wisconsin Chapter 128 cases, in other state receiverships and in federal court. In addition, she represents businesses and other interested parties in bankruptcies, state court receiverships, sales of business assets and out-of-court business restructurings. From 2021-24, she was a senior managing director with DSI, where she worked as a consultant and a fiduciary on the business side and, in doing so, both expanded and rounded out her fiduciary practice. She continues to be a strategic partner with DSI. Ms. DeMarb received her J.D. in 1997 from the University of Wisconsin.

Hon. Beth E. Hanan is a U.S. Bankruptcy Judge for the Eastern District of Wisconsin in Milwaukee and Green Bay, appointed in May 2015. Previously, she was an appellate lawyer and litigator in Wisconsin, and served several terms as managing member of a trial practice boutique, Gass Weber Mullins. Judge Hanan was chair of the Wisconsin Judicial Council and president of the Milwaukee Bar Association, and she remains a Fellow in the American Academy of Appellate Lawyers. Since joining the bench, she has been the judicial co-chair of ABI's annual Wedoff Consumer Conference (in 2020 renamed the Consumer Practice Extravaganza) and has served as the bankruptcy representative to the Seventh Circuit Judicial Council (2019-21). She also chaired the Public Outreach committee of the National Conference of Bankruptcy Judges (NCBJ) from 2020-22 and is a member of NCBJ's Ethics and International Judicial Relations committees. Judge Hanan received her undergraduate degree from Marquette University and her J.D. in 1996 from the University of Wisconsin Law School.

Melissa M. Root is a managing partner with Jenner & Block in Chicago. She focuses on representing creditors, committees, debtors, examiners and trustees in complex financial restructuring matters and high-stakes bankruptcy litigation. Ms. Root represented USA Gymnastics in its chapter 11 case, and a significant part of her practice includes representing committees of retired employees. She also counseled the official committee of government retirees in the Commonwealth of Puerto Rico's Title III case, and she previously represented retiree committees in the Budd Co., American Airlines and Walter Energy cases. Ms. Root also frequently represents parties in bankruptcy-related appellate matters. She served as counsel for the prevailing petitioners before the U.S. Supreme Court in *Wellness International Network, Limited v. Sharif*, and also served as counsel for the American Bar Association in connection with its *amicus curiae* brief in *Executive Benefits Insurance Agency v. Arkinson*, and as counsel for the National Association of Bankruptcy Trustees in connection with its *amicus curiae* brief filed in the U.S. Supreme Court in *Baker Botts L.L.P. and Jordan, Hyden, Womble, Culbreth & Hozer, P.C. v. Asarco LLC*. Ms. Root devotes significant time to *pro bono* work and currently represents a class of former students in the ITT Technical Institute bankruptcy case. She is active in ABI, for which she serves on the advisory committee for several conferences, and she was honored as one of ABI's "40 Under 40" in its 2017 inaugural class. Ms. Root is a Fellow in the American College of

Bankruptcy. She received her B.A. *magna cum laude* in 2000 from Bowling Green State University and her J.D. *cum laude* in 2003 from the University of Michigan Law School.

Elisabeth M. Von Eitzen is a partner with Warner Norcross + Judd LLP in Grand Rapids, Mich., where she focuses her practice on real estate development and financial services. She is admitted to practice before the U.S. Court of Appeals for the Sixth Circuit, the U.S. District Courts for the Eastern and Western Districts of Michigan, the Northern and Southern Districts of Illinois, and the Northern and Southern Districts of Indiana. Ms. Von Eitzen is a member of the American and Federal Bar Associations, the State Bar of Michigan, the Grand Rapids Bar Association and the Kalamazoo Bar Association, and she has been named a *Michigan Super Lawyer* Rising Star since 2013. She received her undergraduate degree with honors from Hope College in 2003 and her J.D. in 2006 with honors from Wayne State University Law School, where she was a member of the Order of the Coif and the national moot court team.